Weekly Credit Brief Aug 20 - Aug 26 2013

Story of the Week

Rupiah forwards plunge to lowest since 2009 as default risk rises

Companies domiciled in Indonesia face the highest risk of default since 2010 as the RMI aggregate 1-year probability of default (RMI PD) for Indonesian firms rose to 31.4bps on August 23. The non-deliverable 1 month forward contract on USDIDR climbed to a four year high of 11,393 following a surge in 5 year credit default swaps (CDS) premium on Indonesian sovereign bonds. The cost of insuring the country's sovereign bonds remained high around 275bps despite measures announced by the Indonesian government to reduce the current account deficit. Measures on the table include higher import taxes and relaxing quotas on mineral exports to address the current account. Meanwhile, the market cap for the Jakarta Composite Stock Index has also fallen 17.93% to IDR 3812tn from its peak of IDR 4690tn on May 20 as investment sentiment eroded.

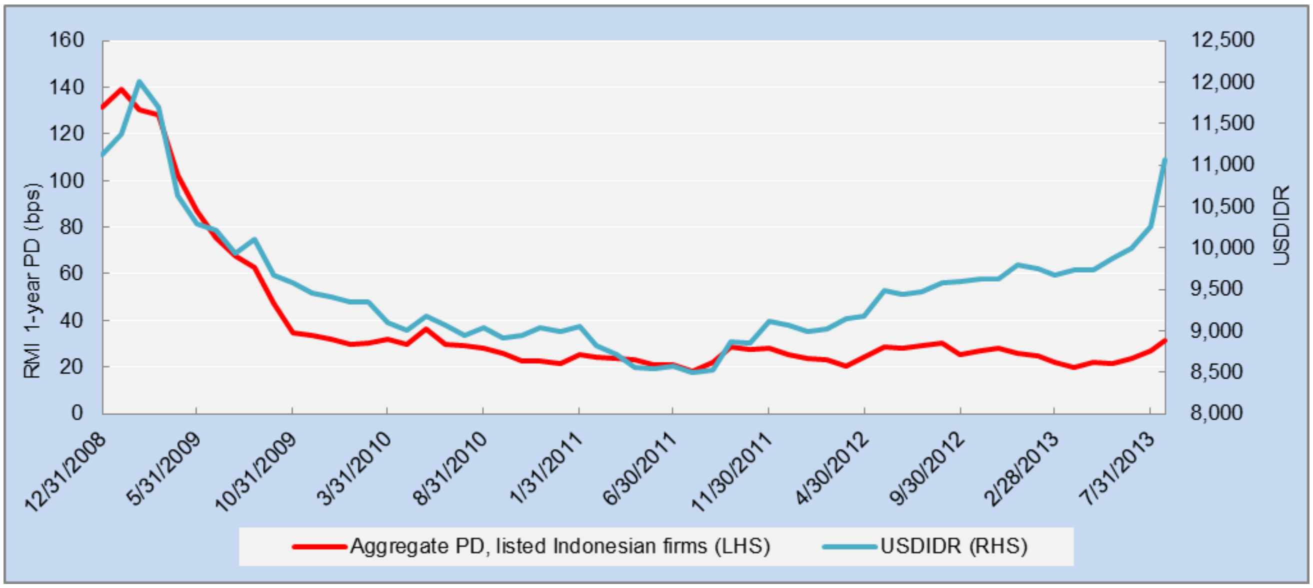

Figure 1: Aggregate 1-year PD for Indonesian firms and USDIDR over the years. *Source: Bloomberg; RMI*

Concerns that the US Federal Reserve may begin tapering US stimulus in September have fueled the IDR decline as most foreign investors seek to exit their investments in Indonesia. Some investors are seeing more trouble ahead as the archipelago deals with slowing economic growth and high inflation.

Fitch warned that the CRA would put Indonesia under review if regulators fail to calm financial market on a falling IDR. All 3 major credit rating agencies (CRAs) have retained their existing ratings for Indonesia's long term debt at BB+(S&P), Baa3(Moody's) and BBB-(Fitch) with stable outlooks for the country. On August 21, Moody's assigned a long-term Baa3 rating to the proposed US dollar trust certificates to be issued by Perusahaan Penerbit SBSN Indonesia III (a special purpose legal entity established for the issuance of trust certificates wholly owned by the government of the Republic of Indonesia), while Fitch assigned a BBB- rating to the same issue, which is in line with Indonesia's foreign currency issuer default rating.

Table 1 displays the industries with the highest and lowest PD correlations with the USDIDR between 2008 and 2013. The table shows the biggest industries are Indonesian banks, construction and real estate firms which are susceptible to USDIDR. They have the highest positive PD correlation during the last 5 years. A plot of their RMI PDs and USDIDR is shown in Figure 2. The sectoral PDs for all three industries declined together with the strengthening IDR between 2008 and 2011. During these years, the strong IDR probably attracted foreigners to invest in Indonesian properties which also led to a growth in loans and boost to the credit profiles for banks. In recent years, the RMI PDs for construction and real estate firms continued to remain low during the continued booming house prices. The RMI PDs for banks, however displayed sharp increases during short periods in 2011 and 2013, in tandem with the weakness in IDR. Indonesian banks could see a higher default risk on possible action by the US Federal Reserves in winding down its massive monetary stimulus program and slowing down banks' credit growth.

Industry	PD correlation coefficient with USDIDR	Number of companies in industry
Engineering & Construction	0.324	6
Banks	0.314	19
Real Estate	0.288	23
Mining	0.248	8
Coal	0.247	7
Retail	0.239	11
Agriculture	0.226	12
Pharmaceuticals	0.211	7
Diversified Financial Services	0.180	13
Food	0.176	12
Chemicals	0.175	12
Building Materials	0.147	8

Table 1: Average PD correlation coefficients with USDIDR for Indonesian sectors with the highest number of companies in the industry. Only companies who reported PDs every month between 2008 and 2013 were considered for this table. *Source: Bloomberg; RMI*

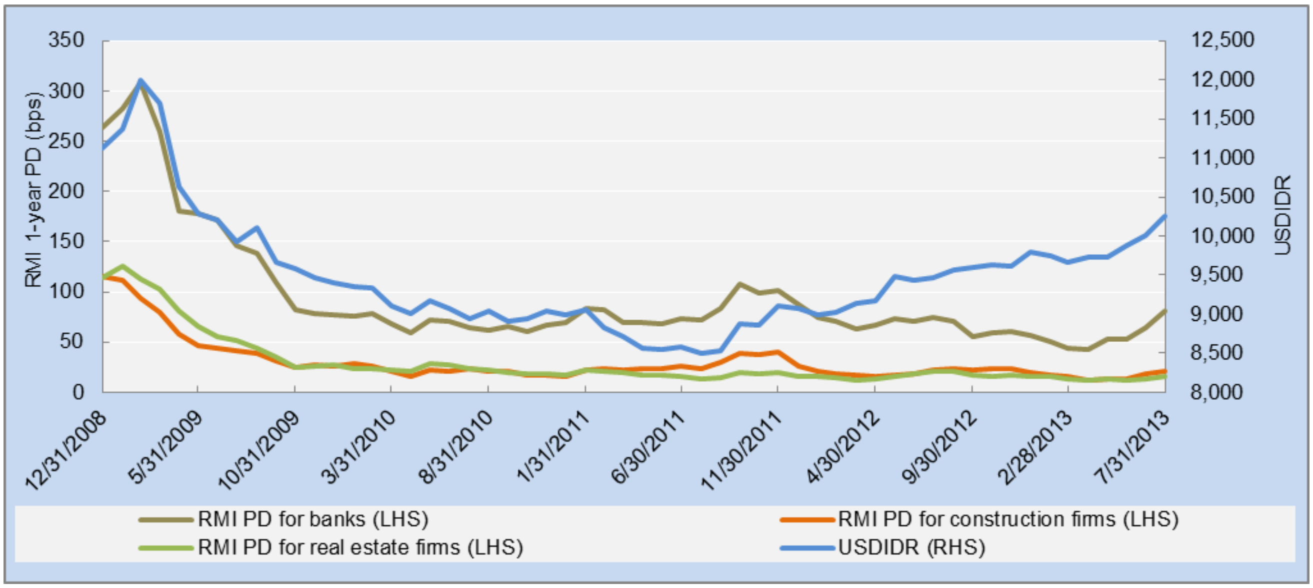

Figure 2: Aggregate 1-year PDs for Indonesian banks, construction and real estate firms and USDIDR over the years. *Source: Bloomberg; RMI*

In the News

Credit Suisse sees 70% payout in GDP warrants

Aug 23. Credit Suisse Group AG raised its growth forecast for Argentina to 3.7% in 2013 from 3%, after official data indicated a 5.1% jump in economic activity during the first half of the year. Credit Suisse estimated that investors of warrants linked to GDP will receive a 5.7-cent coupon in December 2014, a 70% return based on the price of 8.18 cents on August 22, as the Argentinean economy could expand as little as 1.4% in the second half of 2013 and still meet the 3.22% payout threshold. The warrants were issued as part of the country's debt restructuring in 2005, any payout will be contingent upon the outcome of a US legal dispute with creditors from Argentina's record USD 95bn default in 2001. (Bloomberg)

Malaysia cuts 2013 growth forecast as expansion misses estimates

Aug 21. Malaysia's central bank, Bank Negara Malaysia trimmed its GDP forecast for the year to 4.5-5% from 6%, following a second-quarter expansion that fell short of expectations. Malaysia registered a year-on-year GDP growth of 4.3% in Q2, which was lower than the median estimate of 4.7% among economists surveyed by Bloomberg. Meanwhile, Malaysia's diminishing current-account surplus narrowed to MYR 2.6bn on weaker exports, its lowest level in 14 years. (Bloomberg)

Japan manufacturers' optimism hits three-year high

Aug 21. Japanese manufacturers' optimism improved to a three year high as a weak JPY boosted earnings for export sectors such as textiles, chemicals, steel and other metals. The monthly Reuters survey of manufacturers rose 3 points to positive 16 in August, last seen in November 2010. A positive reading indicates optimism. Makers of cars and electronics were however less optimistic due to concerns of deteriorating growth in emerging markets, which can potentially undermine Japanese expansionary policy. (Reuters)

Greek yields hit three-week highs as Germany says third bailout needed

Aug 20. Concerns over Greece's ongoing debt crisis resurfaced last week as German Finance Minister Wolfgang Schaeuble said Greece would probably need a third bailout without further haircuts. Although the announcement was seen as an attempt to reassure taxpayers ahead of Germany's elections next month, worries over the sustainability of Greece's debt sent yields on 10-year Greek sovereign debt to a three-week high of 10.07%. Traders also linked the jump in Greek yields to a bond sell-off in emerging markets stemming from news about the Federal Reserve on a potential tapering of its asset-purchasing program as soon as next month. (Reuters)

UBS sees USDINR at 70 as Rajan lacking magic wand

Aug 20. UBS AG sees a further 10.5% downside to the INR due to a pullout of funds as US prepares to pare stimulus. A collapse in demand Indian rupee bonds sent yields on the 10- year government securities to a five year high of 9.24%. The INR has since fallen almost 14% against the USD since March even the central bank, Reserve Bank of India reduced the amount companies and individuals can invest abroad to stem the INR losses. (Bloomberg)

European junk bond volumes rise as banks retrench (FT)

UK banks face GBP 1.3bn bill over new mis-selling scandal (Economic Times)

Upbeat manufacturing poll suggests China may yet avert debt disaster (Reuters)

Thailand holds rate as rising debt curbs room to aid economy (Bloomberg)

Bond trading hampered as buyers retreat to crowded exits (Bloomberg)

Subprime squeezed as auto-lender costs increase (Bloomberg)

Short seller Glaucus alleges irregularities in China Minzhong (WSJ)

Ringgit declines to three-year low on current-account concern (Business Week)

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